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## Coates' Canons Blog: Court of Appeals Reaffirms New Interpretation of Pre-audit Requirement

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In *Executive Medical Transportation, Inc. v Jones County Department of Social Services*, 735 S.E.2d 352 (NC Ct. App. 2012), *disc. rev. den'd*, 737 S.E.2d 378 (N.C. 2013), the North Carolina Court of Appeals held that an oral agreement between a medical transport company and the county was void because the agreement did not include a written preaudit certificate. As I discussed [here](#), the court interpreted **G.S. 159-28(a)** (commonly referred to as the preaudit requirement) to require that all contractual agreements that obligate a local government or public authority to pay money within the current fiscal year include a preaudit certificate. This holding effectively requires that all such contracts be in writing. The Court of Appeals recently reaffirmed this interpretation of the preaudit requirement in *Howard v. County of Durham*, No. COA12-1484 (May 7, 2013). This post summarizes the *Howard* case and then provides a brief overview of when the preaudit statute is triggered, and what it requires, in light of these recent court of appeals cases.

### **Howard Case Facts**

In *Howard*, the county's tax administrator participated in a federal court mediated settlement conference after a former employee filed a lawsuit alleging wrongful termination and violations of her civil rights. According to the court, the parties reached an "oral agreement to settle for \$50,000" and the mediator prepared a "Memorandum of Settlement" reflecting the agreed upon terms. The former employee signed the memorandum, but the tax administrator refused to sign, claiming that she did not have authority to settle for the agreed upon amount. The tax administrator subsequently told the mediator that she would not recommend that the settlement be approved by the board of county commissioners.

The former employee sued the county for breach of contract and negligent misrepresentation. She claimed, among other things, that the tax administrator entered into an enforceable oral contract on behalf of the county to settle for \$50,000. The county argued that the court lacked jurisdiction because the county was protected by sovereign immunity and that the plaintiff's complaint failed to state a claim because the parties never entered into a valid settlement contract. The county claimed both that the parties never had a "meeting of the minds" to form a valid contract and, even if there was a meeting of the minds, that the oral agreement was not legally enforceable because it lacked the preaudit certificate required by state law. The trial court granted the county's motion to dismiss plaintiff's claims. The plaintiff appealed.

On appeal, the court focused on whether or not the plaintiff had pled a valid contractual agreement. (The county would not have been protected by sovereign immunity for a breach of contract claim if a valid contract existed. On the other hand, the plaintiff would have no cause of action if a valid contract did not exist.) In addressing the contract issue, the court first looked to the rules governing mediation in federal court to determine if settlement agreements must be in writing to be valid. The court noted that the local rules of the Eastern District of North Carolina provide that "mediated settlement agreements 'shall' be in writing." However, because the court could not find a Fourth Circuit case holding that the rules prohibited the enforcement of an oral settlement agreement the court declined to rule on this issue. Instead, it assumed (*arguendo*) that an oral mediated settlement agreement could be enforceable. The court also assumed, without deciding, that the tax administrator had authority to enter into the settlement agreement on behalf of the county. (Although the court appeared somewhat dubious of the tax administrator's authority to bind the county, it did not analyze this issue because the county did not challenge the plaintiff's claim that the tax administrator had the proper authority.) The court then analyzed the county's main defense—that the agreement lacked the requisite preaudit certificate to form a valid contract under **G.S. 159-28(a)**. The court had to determine whether or not the preaudit statute applied to the alleged agreement and, if it did, what it required.

### **Preaudit Statute Applies to Settlement Contracts that Obligate Unit to Pay Money**

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The plaintiff argued that the preaudit statute did not apply to the alleged settlement agreement. She cited to *Lee v. Wake County*, 165 N.C.App. 154, 598 S.E.2d 427 (2004), in which the court had held that the preaudit statute did not apply to a preliminary settlement agreement in which both parties committed to draw up a final settlement agreement. According to the *Lee* court, the preliminary settlement agreement was a contract for specific performance, not a contract “requiring the payment of money or a purchase order,” therefore it did not trigger the preaudit requirement. The *Howard* court found *Lee* distinguishable on this point. (Recall that the alleged settlement contract in *Howard* was an oral agreement by the county to pay the plaintiff \$50,000.) Instead, the court cited favorably to another case, *Cabarrus County v. Systel Business Equipment Co., Inc.*, 171 N.C. App. 423, 614 S.E.2d 596 (2005), in which the court had invalidated a settlement agreement for lack of a signed preaudit certificate, where the agreement, on its face, mandated that the county pay a specified sum to the defendant.

Because the alleged settlement agreement in *Howard* involved the payment of money by the county (presumably in the current fiscal year), the court concluded that the preaudit statute applied.

### **Preaudit Statute Requires Preaudit Certificate on All Contract that Obligate Unit to Pay Money**

Once it determined that the preaudit statute applied, the court then interpreted the statute's provisions in the same manner as it had in *Executive Medical*. Specifically, it held that the statute requires that an agreement that obligates a unit to pay money to include a signed preaudit certificate. According to the court, “[a]n oral contract, by its very nature, cannot contain the written certification required by [G.S. 159-28(a)].”

Thus, the court affirmed the trial court's dismissal of the plaintiff's contract claim because there was no valid contract.

### **New Preaudit Framework**

What can we discern about the preaudit requirement from these recent (and other) cases? I've distilled the current state of the law down to three basic principles:

**1. The preaudit statute is triggered only when a unit orders goods or enters into a contract (or other agreement) which obliges the unit to pay money.** It is not triggered if the purchase order, contract, or agreement does not, by its terms, require the unit to pay money. The requirement does not apply to contracts requiring a unit to undertake a specific performance, even if that indirectly requires the payment of money. And, if the expenditure is accounted for in the budget ordinance, the preaudit requirement also may not apply if the unit does not expect to make any payments under the contract or agreement in the current fiscal year.

For example, the preaudit statute is triggered if a unit enters into a contract to purchase bulk water from another unit of government and, in exchange, agrees to pay the other unit of government a certain fee per month for the water. The preaudit statute is not triggered, however, if that same unit enters into a contract to purchase bulk water from another unit of government and, in exchange, agrees to treat the other government's sewage. This would be a contract for specific performance, not involving the payment of money.

As another example, the preaudit statute is triggered if a unit enters into a one-year contract for landscaping services on July 1 with services (and payments) scheduled to begin that month. The statute does not apply if the same one-year contract is entered into on June 30, with services (and payments) scheduled to begin in July. That is because the contract does not obligate the unit to pay money in the fiscal year in which it was entered into.

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**2. If the preaudit statute is triggered, all three of its requirements must be met or else the purchase order, contract, or agreement is void.** The three requirements are (1) that the unit verify that there is an appropriation authorizing the expenditure in the unit's budget ordinance or in a project ordinance; (2) that the unit verify that sufficient monies will remain in the appropriation to pay any amounts that will come due in the current fiscal year; **and** (3) that the unit affix a preaudit certificate (stating that "This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act") that is signed by the unit's finance officer or a properly designated deputy finance officer. That likely means that all purchase orders, contracts, or agreements that are subject to the preaudit requirement must be in writing. (Note that a preaudit certificate is not required if the contract or agreement has been approved by the Local Government Commission.)

**3. Finally, if the preaudit statute is triggered, and all three of its requirements are not met it could result in personal liability to any employee or official who "incurs an obligation or pays out or causes to be paid out any funds" under the void purchase order, contract, or agreement.** A unit's finance officer is responsible for establishing appropriate policies and procedures to identify when the preaudit statute is triggered and to ensure that all three of its requirements are satisfied.

## Links

- [appellate.nccourts.org/opinions/?c=2&pdf=MjAxMi8xMi01NzMtMS5wZGY=](http://appellate.nccourts.org/opinions/?c=2&pdf=MjAxMi8xMi01NzMtMS5wZGY=)
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